BEFORE THE IDAHO BOARD OF TAX APPEALS

IN THE MATTER OF THE APPEALS OF HEALTH CARE REIT, INC. Consolidated from decisions of the Ada County Board of Equalization for tax year 2013.	)))))	APPEAL NOS. 13-A-1014 & 13-A-1015 FINAL DECISION AND ORDER

COMMERCIAL PROPERTY APPEALS

THESE MATTERS came on for hearing November 25, 2013 in Boise, Idaho before Hearing Officer Travis VanLith. Board Members David Kinghorn, Linda Pike and Leland Heinrich participated in this decision. Attorney Robert Burns, Chief Executive Officer Randall Evaro, and Appraiser Neil Salzgeber appeared at hearing for Vibra Holdings One, LLC, the lessee-operator of the subject properties and the party aggrieved pursuant to Idaho Code § 63-511(1). The appeal is styled under Health Care Reit, Inc. who is the record owner of the subject parcels, however, lessee's representatives appeared and presented argument at hearing. Any reference in the following below to Appellant is understood to refer to the lessee. Deputy Prosecuting Attorney Lorna Jorgensen and Appraiser Bill Mahn appeared for Respondent Ada County. This appeal is taken from the decisions of the Ada County Board of Equalization denying protests of valuation for taxing purposes of properties described by Parcel Nos. R1022760100 and R1022760110.

The issue on appeal concerns the market values of two (2) commercial parcels.

The decisions of the Ada County Board of Equalization are affirmed.

FINDINGS OF FACT

Parcel No. R1022760100 (Appeal No. 13-A-1014)

The assessed value of this unimproved 2.68 acre parcel is $524,900. Appellant requests the value be reduced to $500,000.

Parcel No. R1022760110 (Appeal No. 13-A-1015)

The assessed land value of this 3.922 acre parcel is $768,200, and the improvements' value is $14,442,000, totaling $15,210,200. Appellant requests the land value be reduced to $731,700, and the improvements' value be reduced to $8,500,000, totaling $9,231,700.

The subject properties operate collectively as a long-term acute care hospital (hereinafter "LTACH"). The unimproved parcel serves as paved parking for the larger improved parcel. The Meridian, Idaho facility was built in 2007 and consists of 60,029 square feet of improved space. The facility includes a 60 licensed bed capacity, in addition to other amenities typically found in a LTACH facility, such as: an intensive care patient room, a dialysis bed, a kitchen and cafeteria, a physical therapy room, a CT scanner and x-ray capabilities. The subject LTACH has been in operation since early 2008.

The original operator of the subject LTACH was Boise Intensive Care Hospital, Inc. (BIC). After several years operating with a negative net income, BIC entered into bankruptcy proceedings on December 11, 2012. Appellant, the current operator, assumed operational control of the facility following execution of a lease agreement with Health Care REIT, Inc. dated June 1, 2013. BIC continued to operate the LTACH until Appellant took over.

Appellant discussed some of the primary differences between a LTACH facility and a short-term acute care hospital (STACH). A key difference is in the typical length of patient stays. On average, a patient at a LTACH facility will stay for 25 days. STACH patients, on the other hand, typically stay for three (3) to seven (7) days. The difference is attributable to the type of care offered, which impacts how the respective hospital facilities are designed.

A STACH facility is basically a traditional hospital which focuses on tertiary care. Such facilities normally have emergency rooms, ambulance arrival areas, operating rooms, and other ancillary departments commonly associated with a general hospital type facility. As the name implies, a LTACH facility is designed to provide long term care. Most of a LTACH facility is dedicated to patient rooms.

In the case of the subject LTACH, the only traditional hospital-like amenities are a laboratory and radiology capability. The remainder of the facility is reserved for physical therapy, patient beds, and general long-term care. Appellant explained the subject LTACH compared more favorably to a convalescent facility than a traditional short stay hospital.

Offered in support of Appellant's value request was a retrospective independent fee appraisal report. The effective date of valuation was January 1, 2013. The appraisal first presented a regional and local overview, in addition to a detailed healthcare industry overview which examined general market trends related to the different types of care facilities operating in the broader healthcare market. The appraisal characterized the local healthcare market as strong and displaying signs of positive growth.

Despite a generally favorable local healthcare market, the appraisal found the subject LTACH was underperforming compared to other similar type facilities in Idaho. In looking at the only other two (2) LTACH facilities in the State, the appraisal noted subject's occupancy rate of 36.5% was much lower than the 55.3% and 80.4% rates enjoyed by its competitors. The appraisal attributed subject's underutilization to its large size. The other Idaho LTACH facilities have only 40 licensed beds, compared to subject's 60.

Appellant's appraisal regarded the subject LTACH as super-adequate for current local marketplace demand. Accordingly, in working through the different approaches to value, the appraiser considered subject as a 38-bed facility with 38,000 square feet, which figure represented a 60% utilization rate. It was noted the 38-bed capacity exceeded subject's actual bed utilization rate, which has held steady at roughly 23 beds for several years.

In terms of valuation, the appraisal first developed a value conclusion for subject's acreage. Three (3) sales and one (1) active listing of unimproved commercial parcels were considered. Lot sizes ranged from 1.0 to 4.31 acres with sale prices between $370,260 and $1,408,077, or between $5.00 and $10.24 per square foot. The appraisal examined possible adjustments to the compared properties on the basis of location, size, topography, shape, utilities, and zoning. After individually analyzing these factors, the appraisal concluded the only needed adjustment was for size. The effect of the size adjustment altered the upper end of the sale price range downward to $9.73 per square foot. The appraisal determined a value for the subject LTACH's total acreage of $2,444,457, or $8.50 per square foot.

The appraisal next developed a replacement cost new (RCN) estimate using the cost approach. The RCN conclusion resulted from the calculator method using cost figures obtained from the Marshall Valuation Service. The appraisal used the base cost rate for a Good quality, Class B Convalescent Hospital of $229.15 per square foot. After applying several multiplier adjustments, and adding $3.00 per square foot for subject's sprinkler system, the appraisal calculated a total building improvement cost of $9,352,408. Added to this base figure were site improvement costs, other indirect costs, and entrepreneurial costs. The result was a total RCN conclusion of $12,924,381, or $340.12 per square foot.

From the total RCN, downward adjustments were applied to account for physical depreciation and functional obsolescence. Using a straight-line depreciation approach, a negative adjustment of 12% was applied. As noted earlier, the appraisal considered the subject facility as a super-adequate improvement. As such, the cost approach analysis used a size of 38,000 square feet, or 38 licensed beds. Due to the favorable local market characteristics, no adjustment for external obsolescence was made. After subtracting the total accrued depreciation of $1,807,081, a total depreciated improvement value of $11,117,301 was concluded. After adding land value, the total cost approach value for subjects was $13,600,000, or $357.89 per square foot.

The appraisal next detailed its sales comparison approach. Four (4) LTACH sales and one (1) rehabilitation hospital sale were examined. It was noted the transactions were real-estate only in nature and did not include a business value component. With the exception of Sale No. 1, which was constructed in 1968, the sale properties generally represented subject in terms of age. Likewise, the sale properties approximated subject in terms of square footage, except Sale Nos. 1 and 3, which were notably larger than the 38,000 square feet used for the subject facility. As there were no such sales in Idaho, the sold facilities were located in Nevada, Oklahoma, Texas and Missouri.

The appraisal removed respective land values from the overall sale prices, which prices ranged from $8,181,000 to $33,800,000. The indicated improvement-only prices ranged from $175.75 to $416.64 per square foot. The appraisal further made adjustments to the sale properties for location and effective age, resulting in adjusted improvement sale prices between $279.49 and $474.75 per square foot. A per-square-foot rate of $350 was concluded for the subject improvement, to which a land value of $2,440,000 was added. The total value conclusion under the sales comparison approach was $15,700,000.

In its income approach, the appraisal considered nine (9) acute care facilities regarded as most comparable to subject. Included in the compared properties were three (3) LTACH facilities and six (6) rehabilitation hospitals. Lease rates ranged from $24.70 to $41.19 per square foot. After making adjustments for landlord expenses, age, and location, the adjusted lease rates varied between $24.93 and $49.75 per square foot. The appraisal determined a market lease rate of $32.81 for the subject facility. While other information was considered, Appellant's appraisal focused on capitalization rates derived from the sales considered in the sales comparison approach. The capitalization rates ranged from 7.29% to 9.65%, with a median rate of 8.49%. The appraisal capitalized subject's market-derived net operating income at 8.5%, resulting in a total rounded value indication of $14,700,000.

In the final reconciliation, each of the above three (3) value indications were given weight in arriving at the total real estate only value estimate of $15,000,000. From this, an economic obsolescence adjustment of $5,450,000 was deducted. The economic obsolescence represented the difference between the real estate only value estimate and a so-called going concern value. The appraisal concluded a total real estate only value for the subject LTACH of $9,550,000.

Respondent questioned several aspects of Appellant's appraisal report. Of primary concern was the appraisal's consideration of subject as a 38,000 square foot facility, rather than its actual size of 60,029 square feet. Pointing to Idaho Code § 63-208, which requires that a property's actual and functional use be a major consideration when determining market value, Respondent argued the appraisal was improper. Respondent petitioned the appraisal be disregarded as non-competent evidence of subject's market value.

Respondent explained the 81.36% increase in subject's assessed value from the prior year was the result of a reappraisal effort for 2013, wherein all medical-type properties were reappraised. In looking at subject, Respondent determined it had been improperly included in the county's group/type classification 51/52, as a medical clinic. Viewing subject as more than a medical clinic, Respondent moved the property into the 51/59 group/type classification for hospitals. The primary effect was a decrease in the capitalization rate used in Respondent's income approach analysis from roughly 10.0% to 8.0%, which in turn caused an increase in subject's assessed value.

As subject is an income-producing property, Respondent relied on the income approach to determine the current assessed value. Respondent used an annual lease rate of $24.00 per square foot, or $1,440,516 per year, which was noted to approximate subject's actual annual lease rate of $19.99, or $1,200,000. The lease rate was derived from four (4) lease properties, with lease rates varying from $17.00 to $25.00 per square foot. A typical vacancy rate of 5% and expense rate of 7% were applied. When capitalized at 8.0%, a value of $15,908,699 was calculated. The capitalization rate was gleaned from a healthcare business article, which reported LTACH facilities currently sell in the 7.0% to 9.0% capitalization rate range.

Appellant questioned the lease properties considered by Respondent. Appellant noted the first compared property was a former acute care hospital which was currently being used as medical office space. The second property was challenged because Respondent was unable to clarify whether it was a LTACH or STACH facility. The remaining two (2) properties were noted to be medical offices, which Appellant argued were not comparable to subject.

Respondent also developed value indicators using the cost and sales comparison approaches. Two (2) cost approach analyses were offered. The first valued subject as a Class A average surgical center with a base cost new rate of $249.02 per square foot for the facility. After applying cost modifiers, adding the cost of the paved parking, and allowing 3% depreciation, Respondent calculated a value of $15,320,334 for the improvements. The source of the depreciation factor was the commercial property depreciation schedule furnished by Marshall Valuation Service.

Respondent's alternate cost approach considered subject a Class A good surgical center, with base cost rate of $339.74 per square foot. The same modifiers, depreciation rate, and parking lot value, as determined above, were factored into this analysis. The result was a value estimate of $20,814,100 for subject's improvements. Respondent stated its cost approach values were not relied upon in determining subject's assessed value, but rather were used as a check of reasonableness for the value conclusion reached in the income approach.

Appellant challenged Respondent's use of the Surgical Center valuation table. Appellant contended subject more resembled a convalescent hospital than a surgical center. Respondent acknowledged it had not inspected the subject LTACH to determine whether it had surgical facilities, but stated the determination was based on information from an online source. Appellant offered testimony that subject does not have surgical facilities.

Respondent's sales comparison approach considered two (2) sales and one (1) active listing. Physical details concerning the compared properties were thin, but Respondent reported the facilities had between 45 and 60 licensed beds. The listing, a property located in Ohio, had an asking price of $12,000,000. The sold properties were located in Texas and Indiana. Both sold in early 2013 for estimated sale prices of $23,000,000 and $17,100,000, respectively.

Under the sales comparison approach, Respondent concluded a total value for subject of $16,200,000.

Appellant objected to the properties included in Respondent's sales comparison approach. The objection was based on comparability and the fact that the sales closed after the January 1, 2013 assessment date. Regarding the Texas sale, Appellant provided information which indicated the $23,000,000 sale price included business value. Further, the sale facility included a 12-bed intensive care unit which subject lacks. The Indiana sale was contested because it was a lease-back transaction which Appellant explained could include extra concessions. Without more detail about the terms of sale, Appellant petitioned this latter sale be disregarded.

In support of subject's land value, Respondent submitted a list of four (4) local, unimproved sales which closed during 2010 and 2012. The commercial sale parcels ranged from 3.855 to 4.313 acres in size. Sale prices were between $1,089,000 and $1,638,000, or from $6.26 to $9.75 per square foot. Subject's entire acreage was assessed at $4.50 per square foot, or $1,293,100.

In addition to the above approaches to value, Respondent pointed to other evidence which was argued to support subject's assessment. The first such item came from an asset schedule contained in BIC's bankruptcy filing, which reported a leasehold interest in the subject LTACH of roughly $17,423,087. After questioning by Appellant, Respondent conceded it was unaware how the leasehold value was determined. According to Appellant, the value may have been somewhat inflated due to the below-market lease rate BIC was paying for use of the subject facility.

Respondent further provided information connected with building permit values when the subject LTACH was constructed. The total permit values were $16,272,262, which Respondent noted did not include engineering fees, impact fees, or entrepreneurial profit. Respondent regarded the permit fee information as supportive of the value conclusion reached in its income approach.

CONCLUSIONS OF LAW

This Board's goal in its hearings is the acquisition of sufficient, accurate evidence to support a determination of fair market value, or as applicable exempt status. This Board, giving full opportunity for all arguments and having considered all testimony and documentary evidence submitted by the parties in support of their respective positions, hereby enters the following.

For purposes of taxation, Idaho requires all property be assessed at market value annually on January 1 of the relevant tax year. See Idaho Code § 63-205. Market value is defined in Idaho Code § 63-201 as:

> "Market value" means the amount of United States dollars or equivalent for which, in all probability, a property would exchange hands between a willing seller, under no compulsion to sell, and an informed, capable buyer, with a reasonable time allowed to consummate the sale, substantiated by a reasonable down or full cash payment.

There are three (3) generally accepted methods for determining market value: the income approach, the cost approach, and the sales comparison approach. Merris v. Ada County, 100 Idaho 59, 63, 593 P.2d 394, 398 (1979). Both parties rendered value opinions using each of the above approaches.

While Respondent considered all three (3) appraisal approaches, the income approach was ultimately relied upon in determining subject's assessed value. The other valuation models were offered as a check of reasonableness against the value concluded in the income approach. The Board appreciated Respondent's efforts in this regard, however we found notable concerns with the County's cost and sales comparison approaches.

Respondent's cost approach was developed from the Marshall Valuation Service cost table relating to Surgical Centers. Based on testimony and information provided by Appellant, this appears to be an incorrect classification of the subject facility. As a LTACH facility, subject represents a specific hospital type that generally should not be compared to STACH facilities. A typical LTACH lacks many of the ancillary departments, such as an emergency room, that would commonly be found in a STACH facility. The two (2) hospital types are designed and built for different purposes. Most space in a LTACH facility is dedicated to patient rooms, compared to a STACH facility which houses many different departments. An average length of stay for a LTACH patient is 25 days, compared to an average patient stay of 3 to 7 days in a STACH facility. The type of care provided at these two (2) hospital types is not the same. As such, the design and construction needs are different. Respondent's analysis failed to consider these key differences. In the Board's view, this lack of distinction led to an inflated value under the cost approach.

The Board was likewise concerned with Respondent's sales comparison approach. The analysis included one (1) active listing and two (2) acute care hospital sales. Typically, listings are not considered the best evidence of market value because they do not represent closed sale transactions. As for the sales included in Respondent's model, there was simply not enough information to support the conclusion that they were comparable to the subject LTACH. According to information furnished by Appellant, one (1) of the sale properties included a 12-bed intensive care unit. There was also information provided about both sales which indicated the reported sale price may have included more than just the real estate associated with each transaction. Of more concern to the Board, however, was that Respondent made no attempt to directly compare any of the facilities to subject and make adjustments for property differences. It was not clear how Respondent arrived at a value for subject of $16,200,000. In all, the Board viewed the value conclusion reached under this approach with caution.

Respondent's income approach, on the other hand, was better received by the Board. Respondent developed a lease rate conclusion of $24 per square foot for subject by looking to medical facility leases from the marketplace. Admittedly, there were some questions of comparability between subject and several of the compared properties. This concern was mitigated, however, by Respondent's annual lease rate of $24 per square foot, or roughly $1,400,000, which approximated subject's actual annual lease rate of $19.99 per square foot, or $1,200,000. It should also be noted that both of these lease rates were remarkably less than the $34 per square foot annual rate used in Appellant's appraisal report.

The other components included in Respondent's income approach were also found to be reasonable. The 8.0% capitalization rate was obtained from an independent industry publication, which indicated a LTACH capitalization rate range between 7.0% and 9.0%. Respondent's capitalization rate was similar to the 8.5% rate used in Appellant's appraisal report.

While the Board appreciated the effort undertaken in the appraisal offered by Appellant, the Board found cause for concern with some of the large appraisal adjustments. Most notably was the appraisal's consideration of subject as a 38,000 square foot facility instead of a 60,000 square foot facility, which is its true size. The Board understands the methodology employed to arrive at the 38,000 square foot size conclusion, however, in the Board's view this represented more of a highest and best use analysis, than one which considered subject's actual and functional use. The result of Appellant's special appraisal consideration was zero value attributable to about 22,000 square feet of property in use at subject.

The Board agrees subject may be somewhat over-built for the current local market demand for long-term care, but we are unable to conclude that roughly one-third of the facility is worthless. Such a finding would ignore the mandate in Idaho Code § 63-208(1) "that the actual and functional use shall be a major consideration when determining market value for assessment purposes."

Even if the Board were to accept the size position of 38,000 square feet, the appraisal goes one step further in reconciliation and subtracts an additional $5,450,000 in "economic obsolescence" from the indicated facility value of $15,000,000. The Board had difficulty reconciling these two (2) large obsolescence considerations; particularly as they were not only applied to the cost approach as would be typical, but also to the income and sales comparison approaches, which approaches do not normally involve a separate obsolescence adjustment. Overall, the Board was left with unsettled questions regarding key aspects of Appellant's appraisal.

In appeals to this Board, and in accordance with Idaho Code § 63-511(4), the Appellant bears the burden of proving error in the subject property's assessed value by a preponderance of the evidence. Under the circumstances presented here, the Board does not find that burden was satisfied.

The Board recognizes the prior operator of the subject LTACH was not able to generate a positive net operating income the past couple years, but the owner of the property is currently receiving annual lease payments totaling $1,200,000 from Appellant. This figure was noted to bear a reasonable relationship to the market-derived lease income used by Respondent in its income approach. In other words, the evidence suggests the current lease rate is representative of the market. To find that the assessed value should be heavily discounted due to the prior operator's inability to generate a profit, would effectively ignore the fact that the property generates significant lease revenue to the owner. Such result would be improper in the Board's judgment. Given the totality of the evidence presented, the Board is satisfied the assessed value of the subject LTACH is reasonably supported and reflective of current market value.

For the reasons expressed above, the decisions of the Ada County Board of Equalization are affirmed.

FINAL ORDER

In accordance with the foregoing Final Decision, IT IS ORDERED that the decisions of the Ada County Board of Equalization concerning the subject parcels be, and the same hereby are, AFFIRMED.

DATED this 28th day of April, 2014.